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Research Paper Management

Leverage Analysis of Aurobindo Pharma

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ABSTRACT

Leverage is the key decision area in financial management. This paper concentrates on leverage analysis in Aurobindo Pharma. In this present research paper, an attempt is made to analyze the performance of company, To analyze the leverage analysis in Aurobindo Pharma. The exploratory research design is adopted in this study which employs secondary data .The financial statements of Aurobindo Pharma have been collected over a period of 10 years (2004-05 to2013-14). The data collected is analyzed by the various tools. It is observed that degree of financial leverage is positively correlated with the ROI. The financial performance of the Aurobindo Pharma is satisfactory.

KEYWORDS Combined Leverage, Financial Leverage, Operating Leverage, Sales, EBIT, EBT.

Introduction :-
A lever is a force in a car or in any machine which helps in doing more work with lesser labor. In financial management leverage analysis means arranging fixed assets in such a way that fixed return is ensured. Leverage is a practice which can help a business drive up its gains / losses. In business language, if a firm has fixed expenses in P/L account or debt in capital structure, the firm is said to be levered. Now-a-days, almost no business is away from leverage but very few have struck a balance.

Financial Leverage: Financial leverage is a leverage created with the help of debt component in the capital structure of a company. Higher the debt, higher would be the financial leverage because with higher debt comes the higher amount of interest that needs to be paid. Leverage can be both good and bad for a business depending on the situation.

Financial leverage= % change in earning per share/ % change in earning before interest and tax

Operating leverage: Firm generally purchases the assets, that its operation will produce revenue. When sale increases the fixed cost remains the same and operating revenue will increases. As fixed cost is constant, the % change in operating revenue is more than % change in sale. Hence there is a positive relation between operating leverage and break even point.

Operating leverage= % change in operating profit/ % change in sales

Combined Leverage :-
Combined, or total, leverage is the total amount of risk facing a business firm. It can also be looked at in another way. It is the total amount of leverage that we can use to magnify the returns from our business. Operating leverage magnifies the returns from our plant and equipment or fixed assets. Financial leverage magnifies the returns from our debt financing. Combined leverage is the total of these two types of leverage or the total magnification of returns. This is looking at leverage from a balance sheet perspective.

Combined leverage= % change in earning per share/ % change in sales

Literature Review :-
Myers (2001) states there are many theories that explain the concept of leverage. There exists no universalistic theory about leverage because the explanatory power of theories that might explain leverage is based on various conditions and circumstances. Myers however does not describe or empirically test such conditions and circumstances in his article. More recent research did focused on empirical evidence of determinants of leverage and investigates different settings and conditions in which leverage decisions occur. Although, their study was performed using different sample sizes, different European countries and different type of companies, Bancel & Mittoo (2004) and Brounen etal. (2006) used identical questionnaires to investigate the determinants of leverage in Europe. While they both found empirical evidence that for example

financial flexibility obtained by selecting the timing of issuing debt or equity based on interest rates and market value is the most important determinant of leverage, they used different theoretical explanations for their findings. Furthermore, their findings differed a lot as they found differences (in the extent to) which other variables such as having a target-debt ratio and tax advantages determined leverage.

Leary and Roberts (2005) on the other hand argue that the leverage decisions mainly depend on adjustment costs of leverage instead of the aforementioned determinants. These adjustment costs, both fixed and variable, withhold managers from actively rebalancing their capital structure to an optimal point. In contrast to aforementioned research, De Jong et al. (2008) took the influence of firm-specific factors in leverage decisions into account and conducted a world-wide survey to investigate the leverage determinants. The authors found that country specific factors as creditor right protection, tax rate,bond market development and GDP growth rate have a significant influence on corporate capital structure. Furthermore, there is a difference in the magnitude of firm-specific factors affecting leverage decision in different countries, such as firm growth and profitability. Finally, the authors state that in countries with a better legal environment and relatively more stable and healthier conditions to conduct business, firms relatively take on more debt.

The hypothesis that financial leverage can explain the leverage effect was first discussed by Black (1976) and Christie (1982). Christie (1982) provides empirical evidence—based on a sample of large firms—for the negative relationship between stock returns and volatility induced by financial leverage. Duffee (1995) argues that such a relationship does # not hold when small firms are also included in the sample. Schwert (1989) shows empirically that financial leverage cannot fully account for the observed variation in market volatility. Figlewski and Wang (2000) document a stronger leverage effect in down markets than in up markets.

Objective of the study :-
The main objective of this study is to find out the leverage of the company
1. To understand and analyze the leverage effects of the company.
2. To find out the leverages namely a) operating leverage b) financial leverage c) composite leverage,
3. To study the impact of leverage on Earning per share (EPS).

Sources of Data :-
For study purpose, only secondary data is used which is sourced from the annual reports of the selected companies and websites www.moneycontrol.com and www.bseindia.com. The information relating to nature of company, size, age, state and region, company background, value of total assets and annual financial statements of company for the period of-2004-05 to 2013-2014 have been obtained from the same.

Analysis of Leverage :-
In the financial management leverage is important term which mean firm used fixed nature bearing capital like debt, preference share, and other for giving benefits to equity shareholders and stakeholders. The leverage analysis provides base to the company on which some important decisions can be made. The leverage can be classified into three categories 1. Operating Leverage. 2. Financial Leverage. 3. Combined Leverage.

Table – 1 Analysis of Leverage

Year	Sales	EBIT	Interest	EBT	EPS
2005	1085.07	121.67	39.99	81.68	6.91
2006	1393.64	202.08	60.64	141.44	13.02
2007	1876.09	373.89	76.07	297.82	42.94
2008	2234.63	472.85	59.01	413.84	54.08
2009	2794.9	323.31	81.2	242.11	23.91
2010	3252.06	869.5	62.58	806.92	94.34
2011	4133.12	985.51	55.02	930.49	20.4
2012	4281.45	272.7	267.58	5.12	-1.46
2013	5425.1	984.57	250.06	734.51	17.03
2014	7110.71	1994.27	288.84	1705.43	40.21

If the firm is operating with high leverage a proportionate change in sales will brings a more than proportionate change in EBIT. In the above table in the year 2010 the firm is operating with moderate operating leverage. In the year 2011 it is very law. However when the firm is operating with high leverage if sales increase, EBIT also decreases with more than proportionate change in sales. The calculations of leverage is made by taking the difference between the value in respective two year. The company has an increasing trend in its sales. Further it can be observed from the above table that the company faces continuous fluctuations in its operating leverage. For the safety purpose it is advisable that the firm should maintain stability at lower level as far as the operating leverage is concerned.

Table 2 – Operating Leverage

Year	% Change in Sales	% Change in EBIT	DOL
2005	0	0	
2006	308.57	80.41	0.26
2007	482.45	171.81	0.36
2008	358.54	98.96	0.28
2009	560.27	-149.54	-0.27
2010	457.16	546.19	1.19
2011	881.06	116.01	0.13
2012	148.33	-712.81	-4.81
2013	1143.65	711.87	0.62
2014	1685.61	1009.7	0.6

From the above table it can be seen that the trend in sales position is in increasing position except in the year of 2008 and 2012. In remaining all the years the company has achieved growth in terms of its sales. But in the case of EBIT, the firm is not performing at satisfactory level. There is fluctuating trend in EBIT position. Further the position of DOL is also very poor especially in the year 2009 as a result of reduction in EBIT. It may create risk for the company. Company should take some actions to improve this position and try to achieve stability and increasing trend in its position of Operation Leverage and EBIT.

Table 3 – Financial Leverage

Year	EBIT	EBT	DFL	D/E Ratio	EPS
2005	121.67	41.19	2.95	1.33	13.02
2006	202.08	90.32	2.24	2.13	42.94
2007	373.89	225.98	1.65	1.44	54.08
2008	472.85	339.24	1.39	1.6	23.91
2009	323.31	159.7	2.02	1.02	94.34
2010	869.5	711.46	1.22	0.9	94.34
2011	985.51	805.45	1.22	0.98	20.4
2012	272.7	-137.82	-1.98	0.94	-1.46
2013	984.57	563.12	1.75	0.7	17.03
2014	1994.27	1519.46	1.31	0.7	40.21

Analysis of Financial Leverage :-
It is clear that in the most of years the D/E ratio has decreasing trends except in some years. On the other hand in the financial leverage the trend is fluctuating. In the year 2006 the D/E ratio is 2.13 which is highest during the selected period. On the other hand it is lowest in the year 2013 and 2014 i.e. 0.7.

Table 4 - Combined Leverage

Year	DOL	DFL	DCL
2005	0	2.95	0
2006	0.26	2.24	0.58
2007	0.36	1.65	0.59
2008	0.28	1.39	0.39
2009	-0.27	2.02	-0.55
2010	1.19	1.22	1.45
2011	0.13	1.22	0.16
2012	-4.81	-1.98	9.52
2013	0.62	1.75	1.09
2014	0.6	1.31	0.79

Analysis of Combined leverage :-
Table no 4 shows the level of combined leverage. It shows mix trend. In other words the level of combined leverage is fluctuating. For e.g. in the year 2009 it is -0.54 and in the next year i.e. in 2010 it is 1.45. It is at the highest 9.52 in the year 2012.

Conclusion :-
A study is giving highlight about the leverage, sales and earning position of the company. Leverage is an important factor which is having an impact on profitability of the firm which in turn affects the wealth of the shareholders. It has been observed during the study that there is a negative correlation between DOL and EPS, DFL and EPS, and DCL and EPS.

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